United States Circuit Court of Appeals

For the Ninth Circuit

W. W. KEYES, Trustee of the Estate of CHEHALIS RIVER LUMBER & SHINGLE COMPANY, Bankrupt, *Appellant*, vs. W. C. DAVIE, *Appellee*.	No. 2717

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION.

BRIEF OF APPELLANT

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STATEMENT OF THE CASE.

The bankrupt was a corporation engaged in the manufacture and sale of lumber and shingles. Its daily output was one hundred thousand feet of lumber and one hundred twenty thousand shingles. It employed approximately two hundred twenty men. (Record p. 2). W. C. Davie, the claimant and

appellee here, was the corporation's General Manager, employed at a salary of $300.00 per month. He was one of its trustees and its President. He owned all but one share of its capital stock. His duties as General Manager consisted of general direction and supervision of the entire activities of the corporation. He oversaw the making of sales, the collection of moneys, the buying of timber, the logging and transportation, the manufacturing of lumber, the manufacturing of shingles, the handling of correspondence and office work, the making of banking and financial arrangements, and the hiring and discharging of employes. (Record pp. 6-8.) Mr. Davie had under him a logging foreman, a woods foreman, a sawmill foreman and a shingle mill foreman. In the office were a bookkeeper and a stenographer. Mr. Davie hired and fixed the compensation of everyone employed by the corporation except himself. He was employed by the Board of Trustees, consisting of himself, his wife and his attorney, and his salary fixed by them. (Record pp. 6-8.)

The corporation was adjudged a voluntary bankrupt on September 24th, 1914. At that time there was owing to Mr. Davie as the balance of his salary, earned within the six months next prior thereto, the sum of $587.55. For this amount he filed a claim in this proceeding, asserting a lien and priority therefor under and by virtue of the laws of the State of Washington. (Record pp. 3-5.) To this claim, in so far as it asserted a lien and

priority, the trustee objected for the reason that the claim did not state facts sufficient to entitle the claimant thereto. (Record pp. 5-6.) It was the trustee's contention that the claimant was not one entitled to a lien and priority under the statutes of the State of Washington, giving the same to a person performing labor in the operation of a corporation of the class of which the bankrupt was one, and further that said statutes were supplanted by the provisions of the National Bankruptcy Act dealing with the same subject. The Referee, after a hearing, overruled these objections. (Record pp. 9-11.) A review of the order entered thereon was granted to the trustee and taken to the District Judge (Record pp. 11-13), who made the order, which is complained of on this appeal, affirming the Referee's order (Record pp. 13-14). Thereupon this appeal was perfected. (Record pp. 15-20.)

ASSIGNMENTS OF ERROR.

The following assignments of error are relied upon:

First: That the United States District Court for the Western District of Washington erred in concluding that the statutes of the State of Washington providing for priority of payment to labor claimants in insolvency proceedings was not supplanted by the provisions of the Bankruptcy Act of 1898 dealing with the same subject. (Record p. 15.)

Second: That the Court erred in concluding that the claimant, W. C. Davie, who was the President, one of the directors and the principal stockholder of the bankrupt corporation, was entitled to a lien under and by virtue of the laws of the State of Washington for his services rendered to said bankrupt as its General Manager. (Record p. 15.)

Third: That the Court erred in finding that the proof of claim filed by the claimant, W. C. Davie, stated facts sufficient to entitle him to a lien or priority of payment. (Record p. 15.)

Fourth. That the Court erred in making its order affirming the order of the Referee allowing the claim of W. C. Davie as a lien and priority claim and overruling the objections of the trustee thereto. (Record p. 15.)

ARGUMENT.

The third and fourth assignment of errors are general, and are necessarily included in the first and second assignments and will be considered therewith and not otherwise.

The case of *Wintermote, trustee, v. MacLafferty*, number 2718, on appeal before this court at this term, and submitted herewith, is similar to this case, both as to facts and the law applicable thereto, and we believe should be considered herewith.

We will consider the second assignment of error first.

The appellee is not one entitled to a lien and priority under the provisions of the statutes of the State of Washington giving the same to a person performing labor in the operation of a corporation of the class of which the bankrupt was one.

The court below allowed appellee's claim under Section 1149, Remington & Ballinger's Annotated Codes and Statutes of Washington (Laws 1897, Chapter 43, Section 1). That section reads:

> "Every person performing labor for any person, company or corporation, in the operation of any railway, canal or transportation company, or any water, mining or manufacturing company, sawmill, lumber or timber company, shall have a prior lien on the franchise, earnings, and on all the real and personal property of said person, company or corpora-

tion, which is used in the operation of its business, to the extent of the moneys due him from such person, company or corporation, operating said franchise or business, for labor performed within six months next preceding the filing of his claim therefor, as hereinafter provided; and no mortgage, deed of trust or conveyance shall defeat or take precedence over said lien."

Section 1150 id. (Laws 1897, Chapter 43, Section 2), reads:

"No person shall be entitled to the lien given by the preceding section, unless he shall, within ninety days after he has ceased to perform labor for such person, company or corporation, file for record with the county auditor of the county in which said labor was performed, or in which is located the principal office of such person, company or corporation in this state, a notice of claim, containing a statement of his demand, after deducting all just credits and offsets, the name of the person, company or corporation, and the name of the person or persons employing claimant, if known, with the statement of the terms and conditions of his contract, if any, and the time he commenced the employment, and the date of his last service, and shall serve a copy thereof on said person, company or corporation within thirty days after the same is so filed for record."

Section 1153 id. (Laws 1897, Chapter 43, Section 5), reads:

"Whenever a receiver or assignee is appointed for any person, company or corporation, the court shall require such receiver or assignee to pay all claims for which a lien could be filed under this chapter, before the

payment of any other debts or claims, other than operating expenses."

No lien was filed by appellee in accordance with the provisions of Section 1150, and if he is entitled to priority of payment it is by virtue of the provisions of Section 1153.

Appellee was General Manager of the bankrupt corporation, exercising absolute control over its affairs. He was President, one of three trustees, and owner of all but one share of its capital stock. In view of these facts, was he a person performing "labor" and entitled to priority within the meaning of the above statute? We believe that whether the statute be construed according to the ordinary force of its terms or according to the purpose of its enactment the answer must be in the negative.

First, what was the purpose of this enactment? Courts have repeatedly construed similar provisions in other states and they are uniform in holding that the obvious purpose is, as stated in the language of Bacon, J., in *Coffin v. Reynolds*, 37 N. Y. 640:

> "To protect the classes most appropriately described by the words used, as those engaged in manual labor, as distinguished from officers of the corporation or professional men engaged in its service, in short, to afford additional relief to a class who usually labor for small compensation, to whom the moderate pittance of their wages is an object of interest and necessity, and who are poorly qualified to take care of their own concerns, or look sharply after their employers."

Again in *People v. Remington*, 52 N. Y. 329, it was said:

> "This, like many similar statutes in this and other countries, was designed to secure the prompt payment of the wages of persons who, as a class, are dependent upon their earnings for the support of themselves and their families, and it was not designed to give preference to the salaries and compensation due to the officers and employes of corporations occupying superior positions of trusts and profits."

From these cases, and others which we will hereafter cite, it will be seen that there is sound reason, based upon public policy and welfare, why the wages and earnings of these persons in inferior and subordinate positions should be protected, but such reason does not apply to claims of the nature of that of the appellee herein. There are corporations, such as those enumerated in the statute above, much larger than was the bankrupt in the present case. The general manager of such corporations would draw a considerably larger salary, for instance, it might be $20,000 per year. Then the amount which under the ruling of the court below would be preferred would be $10,000. To so construe the statute is doing violence to the legislative intent. The result would be that the protection given would increase as the necessity therefor lessened, and that it would be greatest when the reason for which it was given was entirely lacking. The appellee in the present case was in control of the corporation's affairs and fully cognizant of its financial condition,

and was undoubtedly in some degree responsible therefor. He was the owner of all but one of the shares of its capital stock, and looking through the corporate entity, was in fact carrying on his own business, and is now seeking to assert a lien and priority against what is in reality his own property. Courts of equity in the distribution of insolvent estates uniformly apply the maxim that "equality is equity." Under this principle, are not the creditors of a bankrupt, who became such at the solicitation of the appellee and who were undoubtedly not so well informed as to the company's financial condition as was he, entitled to at least an equal distribution in its assets as is the appellee?

In *Grubb-Wiley Grocery Co.* (D. C. Mo.), 96 Fed. 183, the court in defining the class described under Section 64b., cl. 4, of the National Bankruptcy Act (Act July 1, 1898, c. 541, 30 Stat. 563), as "workmen, clerks and servants," said in this connection:

> "Indeed, it would present a remarkable feature of the Bankruptcy Act, if the managing officers of a business corporation could vote themselves salaries ad libitum, and after, by their mismanagement, wrecking the company, and inviting an adjudication in bankruptcy, they could, to the exclusion of other creditors of the concern, whose money and property they had obtained on credit, come in as preferred creditors, to the exclusion of such general creditors. The act, in my judgment, admits of no such construction. Such an officer of the corporation being one of its board of managing directors and its general manager, certainly

was not in the mind of the lawmakers, and is certainly not within the spirit of the act, as a preferred creditor."

We next turn our attention to the terms which the statute employs to describe the class intended to be preferred. They are "persons performing labor." The basic word in this phrase is "labor." It is the performance of "labor" for which the priority is given. In one sense the word "labor" includes every form of human endeavor. It is in this sense that we speak of the "labor" of the statesmen for mankind. Needless to say this meaning is not that attributed to the word in common parlance. Its common and usual meaning, as defined in the dictionaries, is services of a manual, menial and mechanical nature, the compensation for which is small. It is services rendered by persons whom public policy demands should be secured and protected to the extent of their scant earning. One who performs "labor" is most appropriately described as a "laborer." The statutes of many states describe the class entitled to priority by terms of broader significance than does the statute of the State of Washington. In many the word "employes," of concededly broader scope, is used.

The most able discussion of who are included within the terms of these statutes, we believe, is in the case of *In Re Stryker* (N. Y. Ct. of App.), 53 N. E. 525. In that case the class entitled to priority was described as "employes, operatives and labor-

ers." The claims of a bookkeeper, a superintendent, a draughtsman, and two foremen were before the court. It was said in denying them:

> "It is said that the applicants were employes of the corporation, and doubtless that assertion is correct. But the word employes would include every person in the service of the corporation without regard to his grade or rank or the nature of his duties. * * * * Although the word employes is used, yet the purpose of the statute was to protect mechanics, operatives or laborers from loss of their wages in the event of the insolvency of the corporation."

In *Michigan Trust Company v. Grand Rapids Democrat*, 113 Mich. 615, 71 N. W. 1102, 67 Am. St. Rep. 486, the statute of Michigan preferred "debts owing for labor." It was held that the services of the editors and reporters of a newspaper were not included.

In *Richardson v. Langston & Crane*, 68 Ga. 658, it was held that a clerk was not a "laborer."

In *Pennsylvania & Delaware R. R. Co. v. Leuffer*, 84 Pa. St. 168, 24 Am. Rep. 189, it was held that a civil engineer was not a "laborer or workman." The court said in part:

> "It is true, in one sense, the engineer is a laborer; but so is the lawyer and doctor, the banker and the corporation officer, yet no statistician has ever been known to include these among the laboring classes. We can not, therefore, even to save a meritorious claim, under-

take to make a new classification, which must necessarily defeat the statutory intent."

In *Pullis Bros. Iron Co. v. Boember*, 91 Mo. App. 85, a superintendent employed at a salary of $1,800 a year, whose duties were "to look after the patterns, the factory and about the building, and see that the men worked," was held not to be within the classification "employes and operatives."

In *Re Directors of American Lace & Fancy Paper Co.*, 51 N. Y. Sup. 818, it was held that a general manager was not within the classification "employes, operatives and laborers." The court said:

> "While it is extremely difficult to lay down any exact rule stating precisely what sort of services it comprehends, it may be said generally that the term 'employes' includes persons employed by corporations in comparatively subordinate positions who cannot be correctly described either as operatives or laborers; such, for example, as bookkeepers, clerks, salesmen and agents engaged at a regular compensation in soliciting orders for goods. No definition, however, can well be adopted which would be broad enough to include a person exercising such a control over the affairs of the corporation as was exercised by the appellant in this proceeding."

In *Lewis v. Fisher* (Md.), 30 Atl. 608, it was held that an attorney employed at a monthly salary was not within the classification "clerks, servants and employes."

In *Casualty Insurance Co.* case (Md.), 34 Atl.

778, it was held that an adjuster was not within the same classification.

The class entitled to priority under the present National Bankruptcy Act is described in Section 64b, cl. 4, thereof, as "workmen, clerks, travelling or city salesmen or servants." It has been held uniformly that such services as those of a general manager are not included.

In re Carolina Co-operage Co. (D. C. N. C), 96 Fed. 950.

In re Greenberger (D. C. N. Y.), 203 Fed. 583.

In re Albert O. Brown (D. C. N. Y.), 171 Fed. 281.

In re Crown Point Brush Co. (D. C. N. Y.), 200 Fed. 882.

In re Continental Paint Co. (D. C. N. Y.), 220 Fed. 189.

The same general principles under which a general manager is held not entitled to priority under the National Bankruptcy Act, would seem to exclude him under the state law. It can no more logically be said that the state legislature intended to protect the general manager than that congress intended to do so.

In *Re Stryker, supra,* it was said:

"It is significant to note that insurance and moneyed corporations are excepted from the operation of the statute. There was no reason for exempting these corporations, but for the fact, well known, that they do not employ

> "labor" in the ordinary sense of the word. The conduct of the business of these corporations requires a large clerical force, rated and organized according to the extent and necessities of the business. If it was intended to protect the claims of this class of employes there was no reason why all corporations should not be included within the scope of the statute."

The same criticism applies to the statute in question. The classes of business described are those in which "labor," within the common meaning of that term, is principally employed. If it was intended to protect such claims as that of appellee in this case, no reason exists why persons rendering services in all classes of business should not be included within the protection of the act. Certainly the claim of a clerk in a clothing store, employed at $60 per month, is as much entitled to priority as that of the appellee here.

The court below relied chiefly upon *In re Lawler*, 110 Fed. 135, decided by Hanford, J., of the district court from which this appeal is urged. We believe that that decision is erroneous, and since it was rendered by the same court from which this appeal is taken, and was the basis for the present decision, we feel that we are in a sense appealing from that decision, too, and that our attitude toward it should be the same as toward the decision in the present case. The reason why that decision is correct, if it is correct, should be fully presented anew to the court by the appellee. The court in that case construes the word "employes," contained in the title

of the act, rather than the word "labor," by which the class entitled to priority is described, contained in the body thereof. Salesmen, however, generally occupy positions of a subordinate character, and their services are somewhat menial and clerical and easily distinguishable from those rendered by the appellee in the present case.

Hanford, J., in the decision of the *Lawler* case, applied what he termed a liberal construction under the provisions of Section 1147, Remington & Ballinger's Annotated Codes and Statutes of Washington. That section reads:

> "The provisions of law relating to liens created by this chapter, and all proceedings thereunder, shall be liberally construed with a view to effect their objects."

This liberal construction is directed only for the purpose of *effecting the object* of the act. If the object of the act is as uniformly stated by the courts, the same is in no way effected by a construction thereof including the claim of the appellee in this case. It is announced in *Nunz v. Cumberland Gap Park Co.* (Tenn.), 52 S. W. 999, 76 Am. St. Rep. 650, 47 L. R. A. 273, that the provision for liberal construction does not apply to the class of persons entitled to the priority, but to the other phases of the enactment, such, for instance, as to the property to which the lien given attaches.

It was said along this line in *People v. Remington*, 52 N. Y. 329:

> "Legislation of this character confers upon a class of persons having a specific contractual relation with corporations, new and unusual privileges and securities at the expense of other creditors, whose distributive share of the assets is diminished. It is in derogation of the common law, and should not be extended to cases not within the reason as well as within the words of the statute. In the distribution of the assets of insolvent corporations by courts of equity, the maxim that equality is equity is a fundamental rule; and it is only by force of legislation that this principle can be departed from, and then only in favor of the class of creditors that come within the scope of the statute when fairly and reasonably interpreted."

Counsel for appellee cited several cases in the court below holding that architects were entitled to liens under mechanic's lien laws. These cases are easily distinguishable from the present case. The purpose of mechanic's lien laws is for the protection of material men and others. It has not as its sole object the protection of the laborer dependent upon his daily wage for his sustenance. Courts which have excluded the general manager under statutes similar to the one in question, have allowed the claims of architects. See *Stryker v. Cassidy*, 76 N. Y. 50, 32 Am. Rep. 262.

The question presented on this appeal has never been before the Supreme Court of the State of Washington, and its decisions throw no light thereon. The case of *Cors & Wagner v. Ballard Iron Works*, 41 Wash. 390, 82 Pac. 713, is cited by

the court below. In that case certain stockholders were employed by the corporation. At a meeting of such stockholders a resolution was adopted to the effect that they should receive certain compensation for their services, provided the business made that amount over and above all expenses. One of the stockholder employes was entitled "general manager." He received $100 a month. Another was president. He received $3.50 a day. Another was foreman. He received $4.00 a day. The decision is without facts which might enable us to determine whether the services rendered were of a manual character or not. The amounts paid however, would indicate their manual character. It is significant that the court throughout its decision refers to these amounts as "wages." The creditors objecting to the allowance of the claims relied solely upon the proviso in the resolution that the wages should be paid in case the business made that amount over and above all expenses. The claimants contended, however, that the resolution from the time of its adoption was regarded as a nullity, and that the various stockholders were regularly credited with the amount of their wages upon the books of the company. The court passed upon the matter as one of fact, and so stated. It is noteworthy that the decision does not contain the citation of a single case.

The wages of laborers, mechanics and domestics has been the subject of protective legislation in this and other countries from time immemorial,

and the courts have on numerous occasions passed upon and construed the enactments with reference thereto. We have examined a great number of these decisions, and we believe that the construction placed upon the term "labor" by the court below is the broadest which it has ever received by any court, and that it is not in accordance with either the purpose of the act or the common usage of the terms.

We will now discuss the first assignment of error.

The statutes of the State of Washington under which appellee claims priority are supplanted by the provisions of the National Bankruptcy Act dealing with the same subject.

This question was before this court in the case of *Blessing v. Blanchard*, 223 Fed. 35. In that case it was held that the claim of a general manager of an automobile concern, employed at a salary of $300 per month, was not entitled to priority under the statutes of the State of California. It therefore did not become necessary to decide whether the state statute was supplanted or not. The statutes of the State of Washington, above set forth, deal with the rank in order of payment of claims for labor. Section 64b., cl. 4, of the Bankruptcy Act deals with the same subject. Section 64b. provides:

> "The debts to have priority, except as herein provided, and to be paid in full out of the bankrupt estates, and the order of payment shall be * * * * (4) wages due to workmen, clerks, travelling or city salesmen or servants,

> which have been earned within three months before the date of the commencement of the proceedings, not to exceed $300 to each claimant; and (5) debts owing to any person who by the laws of the states or the United States is entitled to priority."

Appellee is not entitled to a lien under the state statute, for the reason that Section 1153, supra, provides the order of priority in the case of the appointment of a receiver and directs that such receiver shall pay them accordingly. This provision converts the inchoate right of lien into a priority and makes the same subsequent to operating expenses, which it would not otherwise be. The legislature undoubtedly deemed that the orderly administration of insolvent estates demanded that a multiplicity of suits by reason of foreclosure of liens should be avoided, and that a priority should be substituted for the unperfected lien right. If the priority thus given is introduced into the Bankruptcy Act it is by virtue of the provisions of Section 64b., cl. 5, supra. Now, congress having spoken specifically on the question of labor claims in Section 64b., cl. 4, can it be construed that a different and conflicting priority as to the same matter is introduced into the statute under the general language used in Section 64b., cl. 5? A well known rule of statutory construction would indicate not. See Suth. St. Const., Section 158.

The leading case on this question is *In re Rouse, Hazard & Co.* (C. C. A. 7th Cir.), 91 Fed. 96. In that case the bankrupt ceased doing business on Au-

gust 31, 1898. By the provision of the Bankruptcy Act no involuntary petition could be filed before November 1, 1898. When bankruptcy ensued the labor claimants were without the ninety-day priority period allowed by Section 64b., cl. 4. They asserted priority by virtue of clause 5 and a broader state statute.

The Circuit Court of Appeals denied priority under clause 5. It said:

> "Our conclusion is that Congress having spoken specifically on the subject of priority of payment of labor claims, what it has said upon that subject expresses the particular intent of the lawmaking power, and that provision is not to be tolled or enlarged by any general prior or subsequent provision in that act. That which is given in particular is not affected by general words. So that the statute providing for the priority of payment of debts referred to in clause 5 must be construed to mean other debts and different debts than those specified in clause 4. We are not unmindful of the particular hardship which our conclusion, it is said, will work out. It arises from the fact that under the law proceedings in bankruptcy, except by voluntary act of the bankrupt, could not be commenced in time to fully protect these labor claimants. We regret that this is so. It is a misfortune arising from the provisions of the act, but to remedy this particular wrong we cannot override a recognized canon of construction of statute law."

A similar question was before the court in *Re Lewis* (D. C. Mass.), 99 Fed. 935. It was there said:

"It has been held that state laws, giving priority to wages, though included in the terms of section 64b., cl. 5, are yet ineffectual, because the whole matter of wages is dealt with and regulated by section 64b., cl. 4. *In re Rouse* (D. C.), 91 Fed. 514. In other words, although the laws of a state giving priority to certain debts are by section 64b., cl. 5, introduced into the scheme of the present bankrupt act, yet such state laws are so introduced only so far as the debts to which they give priority are not expressly dealt with as to priority in the bankrupt act itself. Where both a state law and the bankrupt act give priority to the same class of debts, the bankrupt act not only controls the two, but, by its express regulation of these priorities, excludes the state law altogether."

See Collier on Bankruptcy, 10th Ed. p. 912.

With reference to the same matter it was again said In *Re Shaw* (D. C. Pa.), 109 Fed. 782:

"The question has already been decided by the circuit court of appeals for the sixth circuit in *Re Rouse, Hazard & Co.*, 1 Am Bankr. R. 240, 33 C. C. A. 356, 91 Fed. 96, in favor of paragraph 4, and the referee followed this decision. I agree with the correctness of this ruling, which, indeed, seems to me to be scarcely susceptible of doubt. Paragraph 4 deals specifically with the allowance of claims for wages; and, while it is true that wages might be included under the general word "debts," used in paragraph 5, thus to include them would violate a well-known rule of statutory construction. Having been specifically dealt with in the paragraph immediately preceding, it is almost incredible that congress should straightaway proceed to deal with them again in a different fashion."

It was otherwise held in *Re Slomka* (D. C. N. Y.), 117 Fed. 688. Upon appeal the district court was reversed in *Re Slomka* (C. C. A. 2nd Cir.), 122 Fed. 630.

Similar rulings were had in:

In re Crown Point Brush Co. (D. C. N. Y.), 200 Fed. 882.

In re Crawford Woolen Co. (D. C. W. Va.), 218 Fed. 551.

The Bankruptcy Act is entitled "An act to establish a uniform system of bankruptcy throughout the United States." "Uniform," as used in this title, must mean uniform as between the several states. It expressly provides a "uniform" manner for the payment of labor claims. Congress undoubtedly had in mind in the enactment of this provision the various provisions of statutes in the several states with respect to this subject. It found them not to be in harmony either as to the persons entitled to priority, the amount for which priority was given, nor the limitation of time over which it extended. With this divergence in its knowledge congress spoke on the subject specifically and particularly and limited the amount and the time and fixed the class of persons entitled thereunder. It is not to be presumed that congress in the general provision immediately following intended to derogate from this express enactment. Congress must be presumed to have intended what it stated with par-

ticularity, rather than what might be inferred from the use of the general terms.

We believe that Section 64b., cl. 4, supplants the state statutes in the present case, and that, even though the court should conclude that appellee was entitled to priority under the statutes of the State of Washington, such statutes are not applicable.

It is respectfully submitted that the order of the court below allowing the appellee a lien and priority for the amount of his claim should be reversed.

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